Craig Douglas Whatman

"BANKERS AS CONSTRUCTIVE TRUSTEES"

LLM Research Paper

Business Finance Law (LAWS 543)

Law Faculty
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Contents

1 INTRODUCTION

It is well established that the predominant relationship between a bank and its customer is that of debtor and creditor,[1] not trustee and beneficiary. A bank is not normally trustee of its customers for the amount standing to their credit in their bank accounts.

However, along with other "strangers" (ie to the trust or fiduciary relationship), a bank that interferes in a trust or fiduciary relationship[2] may be treated as a constructive trustee merely as a way of obtaining equitable relief by way of personal liability to account as if it had been an express trustee. But the imposition of a constructive trust as a personal remedy is quite distinct from the proprietary trust of specific property.

Where the trust property or its traceable product is still in the hands of the bank, the bank holds the property as trustee subject on the terms of the original trust, unless it was a bona fide purchaser for value without notice of the original trust.[3] This situation is covered by the law of priorities, assisted if necessary by tracing principles. However if the bank has parted with the trust property or its traceable product, it can only be held liable to account for the value of the property.

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[1] Foley v Hill (1848) 2 HL Cas 28.

[2] The relationship need not be of a formal kind.

[3] D Hayton "Personal Accountability of Strangers as Constructive Trustees" (1988) 27 Mal LR 313, 314.

The seminal statement of the liability of a stranger to a trust as constructive trustee appears in the judgment of Lord Selborne in Barnes v Addy.[4] His Lordship stated that:[5]

> ... strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.

As a result of Lord Selborne's statement the two main categories of a stranger's liability as constructive trustee have been labelled "knowing receipt or dealing" and "knowing assistance".

2 KNOWING ASSISTANCE

2.1 Elements of Liability

People who do not themselves receive trust property or who receive it only in their capacity as agents, may incur liability to the beneficiaries of the trust if they knowingly assist in a dishonest and fraudulent design on the part of the trustees.[6] The elements of this head of liability are:[7]

(i) the existence of a trust or fiduciary relationship;

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[4](1874) 9 Ch App 244.

[5]Above n4, 251.

[6]Barnes v Addy (1874) 9 Ch App 244, 251.

[7]Baden, Delvaux and Lecuit v Société Général pour Favoriser le Développement du Commerce et de L'Industrie en France SA [1983] BCLC 325,404.

(ii) the existence of a dishonest and fraudulent design on the part of the trustees;

(iii) the assistance of the stranger[8] in that design; and

(iv) the knowledge of the stranger.

2.2 Existence of a Trust

It is clear from Baden Delvaux and Lecuit v Société Général pour Favoriser le Développement du Commerce et de l'Industrie en France S.A[9] that the trust does not have to be in writing. It is sufficient if there is a fiduciary relationship. In Baden Delvaux directors who misapplied their company's assets were held to be in a fiduciary relationship with the company for the purposes of the "knowing assistance" head of liability.

Several recent New Zealand cases have questioned the need for this element at all.[10] In Elders Pastoral Ltd v Bank of New Zealand[11] the Court of Appeal took the view that a fiduciary relationship is no longer a necessary prerequisite for a constructive trust. Cooke J held that a trust may be imposed whenever someone receives money or other property which consistently with good conscience cannot be retained.[12]

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[8] In this context "stranger" means a third party to the trust, including a bank.

[9] Above n7.

[10] See Elders Pastoral v BNZ (1989) 2 NZLR 180, 186; Powell v Thompson (1990) 1 NZ ConvC 190,663, 669; and In re Goldcorp Refiners and Goldcorp Exchange (1990) unrep, M1450/99 M1332/89, M1572/89, CP21/88 (Christchurch Registry), 109.

[11] [1989] 2 NZLR 180.

[12] Above n11, 186.

This decision heralded the emergence of the remedial constructive trust in New Zealand. Based on principles derived from de facto relationship cases, this type of constructive trust demands no special relationship between the parties. It is simply,[13]

> ... a device for imposing a liability to account on persons who cannot in good conscience retain a benefit in breach of their legal or equitable obligations.

The interesting question, following Elders Pastoral, is how far equitable concepts derived from family law can be extended into the commercial arena without impinging on well-established contractual principles. One such principle concerns the relationship between banker and customer. The threat of liability as a constructive trustee imposes an onerous burden on banks in dealings with their customers. Banks are now being forced to make probing enquiries about the origin of deposited funds. Such enquiries would not have even been considered ten years ago.

2.3 Dishonest and Fraudulent Design

In the context of the elements of "knowing assistance", 'dishonest' and 'fraudulent' have their ordinary meaning, as employed in the criminal law.[14] They go no further than mere moral reprehensibility.[15] In Belmont Fiance Corporation Ltd v Williams Furniture Ltd,[16] the Court of Appeal held that there was no distinction between fraud and dishonesty

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[13] Elders, 193.

[14] See PJ Smart "The Constructive Trust in the Law of Theft" [1986] NLJ 913.

[15] Belmont Finance Corporation Ltd v Williams Furniture Ltd [1979] Ch 250, 267; Baden Delvaux]1983] BCLC 325,407.

[16] Above n15.

and that the words had identical meanings. It was important, in the Court's unanimous view, to preserve certainty.

2.4 Assistance

This word has not been fully defined in the cases although some partial definitions have appeared. In Baden Delvaux Gibson J stated that whether assistance has been given is a question of fact. He later gave an example of a bank giving assistance: if one banker transferred funds to another on the orders of directors of a company, in a situation where the directors were misapplying the assets of the company, the bank would have given the necessary assistance. This is similar to the view expressed by Lawson J in International Sales and Agencies Ltd v Marcus,[17] that where 'funds disposed of in breach of constructive trust reach other quarters', then the necessary assistance would have been given. A bank will be held to have assisted a dishonest trustee if the bank helps the trustee to carry out the fraudulent design. However, the bank must play a proactive role such as transferring trust funds to a third party.

2.5 Knowledge

The scope and extent of the required knowledge has proved most controversial in "knowing assistance" cases. It is vital, in this respect, to distinguish between knowledge and notice. Notice here is a purely equitable concept, rooted in the equitable

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[17] [1982] 3 All ER 551.

jurisdiction against fraud. It was never adopted by the courts of common law, which preferred instead to develop their own concept of knowledge. Inevitably, there was some overlap between what equity regarded as notice and what the common law treated as knowledge. As Hayton points out,[18] the muddled case law in this area has partly arisen out of confusing these two concepts.

2.6 The Baden Delvaux Categories

In Baden Delvaux Peter Gibson J accepted the plaintiff's submission that knowledge for the purposes of constructive trusteeship can comprise one of five different mental states:[19]

(i) actual knowledge;

(ii) wilfully shutting one's eyes to the obvious;

(iii) wilfully and recklessly failing to make such enquiries as an honest and reasonable man would make;

(iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; or

(v) knowledge of facts which would put an honest and reasonable man on enquiry.

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[18] "The Stranger as Constructive Trustee" [1987] 46 CLJ 395.

[19] pp 407-408.

With respect, this complicated analysis of "knowledge" seems questionable. First, a "wilful shutting of eyes" under category (ii) is not a lesser degree of knowledge than actual knowledge, but evidence from which a court may infer actual knowledge.[20] "Wilful blindness" is the equivalent of actual knowledge in most cases because the court will impute actual knowledge on to the defendant. Secondly, categories (iii), (iv) and (v) do not by any ordinary meaning of the word constitute 'knowledge'. However, categories (iii) and (iv) are distinguishable from (v) because they at least involve a degree of subjective awareness.

The categories in Baden Delvaux begin with the adoption of a totally subjective test based on actual knowledge and end with a totally objective test based on a hypothetical honest and reasonable person. Categories (iv) and (v) derive from Selangor United Rubber Estates Ltd v Cradock (No 3).[21] In that case Ungoed-Thomas J concluded that the knowledge required to hold a bank liable as a constructive trustee in a dishonest and fraudulent design was knowledge of circumstances which would indicate to an honest and reasonable man that such design was being put into effect or would put an honest and reasonable man on enquiry as to whether it was being put into effect. His Lordship did not distinguish between these two alternatives, regarding them both as constructive notice.

It is submitted that category (iv) on the Baden Delvaux scale cannot be equated with constructive notice. A person who knows all the facts relevant

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[20] English & Scottish Mercantile Investment Company v Brunton [1892] 2 QB 700, 707; Thompson v Clydesdale Bank Ltd [1893] AC 282, 291.

[21] [1968] 2 All ER 1073.

to a given matter, but who fails to appreciate their factual or legal significance, cannot be said to have constructive notice because the doctrine of notice is "wholly founded on the assumption that a man does not know the facts."[22] Such a person is regarded as being subjectively more aware of the situation than someone who is deemed to know about it by virtue of constructive notice.

The decision in Selangor was followed by Brightman J in Karak Rubber Co Ltd v Burden (No 2)[23] and by John Mills QC sitting as Deputy Judge in Rowlandson v National Westminster Bank Ltd.[24] Karak concerned a takeover of the plaintiff company which involved the use of the plaintiff's own assets to buy out shareholders. In a reference to the defendant bank's assistant branch manager, Brightman J said: "I am completely satisfied that he entertained no suspicion whatsoever of any impropriety at any relevant time."[25] Nevertheless, the judge held that a reasonable banker would have been put on enquiry as to the propriety of the particular transaction.

The decisions in these cases were harsh because of the complete good faith of the respective banks. There are several reasons why the court was able to consider that the banks had constructive notice when, in reality, they had honestly failed to draw the necessary inferences or make the necessary enquiries. First, in previous authorities knowledge and notice were treated as if interchangeable.[26] They are not so, since knowledge involves a degree of awareness

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[22] English & Scottish Mercantile Investment Company v Brunton [1892] 2 QB 700, 707.

[23] [1972] 1 All ER 1210.

[24] [1978] 3 All ER 370.

[25] Above n23, 1221.

[26] See Backhouse v Charlton (1878) 8 Ch D 444, 449; Re Blundell (1888) 40 Ch D 370, 381-383.

and notice does not.[27] Secondly, in many cases judges have found no actual knowledge and then added in emphasis that there were no grounds for such knowledge.[28] This has led to the contention that the presence of grounds for knowledge is itself enough for the imposition of a constructive trust. Thirdly, judges have often refrained from findings of actual knowledge in circumstances where they might easily have made such a finding.[29]

For a long time these developments justified courts imposing constructive trusteeship on banks which had acted honestly on the instructions of their principals. Baden Delvaux brought the "knowing assistance" head of liability very close to the common law tort of negligence.[30] Bankers became liable if they should have realised that there was a fraud, and should have made enquiries but did not do so. Thankfully, from the banks' point of view, this trend has been reversed in recent times.

2.7 The Scope of Knowledge Limited

The Selangor line of authority has been severely criticised by academic commentators in recent years[31] and is open to a fundamental objection. In Barnes v Addy[32] the stranger's liability as a constructive trustee depended upon his assistance with knowledge in a dishonest and fraudulent design on the part of the trustees. While it is clear that Lord Selborne did not intend the test of knowledge to be entirely

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[27] Carl Zeiss Stiftung v Herbert Smith & Co (No 2) [1969] 1 Ch 276, 296, per Sachs LJ.

[28] See Williams v Williams (1881) 17 Ch D 437, 445; Thomson v Clydesdale Bank Ltd [1893] AC 282, 287.

[29] Bodenham v Hoskyns (1852) 21 LJCh 864, 873; Shields v Bank of Ireland [1901] 1 IR 222, 229.

[30] NA Clayton "Banks which Knowingly Assist" [1989] 2 JIBL 70, 74

[31] D Hayton "Personal Accountability of Strangers as Constructive Trustees" (19850 27 Mal LR 313, 318; C Harpum "The Stranger as Constructive Trustee" (1986) 102 LQR 114, 154; P Birks "Misdirected Funds; Restitution from the Recipient" Lloyd's Mar & Com LQ (Aug 1989) 296, 336.

[32] Above n6.

subjective, he was also insistent that a stranger should not be liable if he acted honestly and without fraud. As Harpum points out, [33] Lord Selborne must therefore have intended knowledge to mean actual knowledge or a wilful shutting of eyes, (categories (ii) and (iii) on the Baden Delvaux scale) but nothing else. The fraudulent design assisted and the stranger's knowledge of it must be integrally connected, so that the stranger is party or privy to the design. The stranger is liable because he is implicated in that fraud. Innocent failure to make what is subsequently held to be a proper enquiry, so leading to an innocent failure to know of dishonesty, can hardly make one a party or privy to such dishonesty.

It is submitted, therefore, that strict constructive notice of a dishonest and fraudulent design is not sufficient to impose personal liability to account on a banker as constructive trustee. The banker must be privy to the trustees' wrongdoing through subjective awareness raher than objective notice.

Since Selangor the English Court of Appeal has attempted to limit the scope of knowledge required for liability as a "knowing assistant". The Court has introduced a requirement of want of probity on the part of the stranger which cannot be derived from a state of mind which is negligent but honest.[34] In Consul Development Property Ltd v DPC Estates Property Ltd[35] an important role was given to the concept of conscience. Stephen J considered that

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[33] "The Stranger as Constructive Trustee" (1986) 102 LQR 114, 147.

[34] Carl Zeiss Stiftung v Herbert Smith & Co (No 2) [1969] 2 Ch 276, 296 (Sachs LJ) and 301 (Edmund Davies LJ); Belmont Finance Corporation Ltd v Williams Furniture Ltd [1979] Ch 250, 267 (Buckley LJ); Nihill v Nihill [1983) unrep, CA Transcript 276 (Civil Division).

[35] (1975) 132 CLR 573.

only actual knowledge or deliberately failing to make enquiry so as not to discover fraud would be sufficient knowledge to give rise to liability. In his Honour's opinion, if any other type of knowledge was to count then liability would be imposed without the conscience of the defendant being in any way affected.

Similarly, in Belmont Finance Corporation Ltd v Williams Furniture Ltd[36] Buckley LJ, with whom Orr LJ agreed said:[37]

> The knowledge of that design on the part of the parties sought to be made liable may be actual knowledge. If he wilfully shuts his eyes to dishonesty, or wilfully or recklessly fails to make such enquiries as an honest and reasonable man would make, he may be found to have involved himself in the fraudulent character of the design or at any rate be disentitled to rely on lack of actual knowledge of the design as a defence. But otherwise, as it seems to me, he should not be held to be affected by constructive notice.

This passage emphasises the need for a want of probity on the part of the stranger before liability will be imposed. The stranger's conscience can only be affected in this way if he becomes aware of the trustees' fraudulent design or deliberately ignores facts which would lead to such an awareness.

In Lipkin Gorman v Karpnale[38] a bank was directly involved. Mr Cass, a compulsive gambler and a partner in the plaintiff firm of solicitors,

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[36] [1979] Ch 250.

[37] Above n36, 267.

[38] [1987] 1 WLR 987 (High Court) and [1989] 1 WLR 1340 (Court of Appeal).

misappropriated monies from his firm's client account maintained at Lloyd's Bank. The monies were exchanged for gambling chips at the Playboy Club in London and were then gambled away by Mr Cass. Over two hundred thousand pounds were lost in this fashion.

An employee of the bank, Mr. Fox, knew that Mr Cass was a compulsive gambler and this fact had been noted on the bank's personal memorandum cards for Mr Cass's account. That account was maintained at the same branch as the solicitor's account. However, no evidence was produced during the proceedings that Mr Fox knew the source of Mr Cass's gambling money.

It was sought, inter alia, to fix Lloyd's Bank with a constructive trust for the monies lost by Mr Cass through his gambling. The basis of such a trust was alleged to be the facilitation of Mr Cass's theft from the firm's trust account.

At first instance, Alliot J refused to follow Selangor and said that negligence or carelessness by a banker could not be equated with the dishonesty necessary to create a constructive trust. However, the bank was still held to be liable. According to His Lordship a number of incidents had occurred to make clear to the bank Mr Cass's gambling and the lies which he told to attempt to hide it. Consequently, Alliot J held that Mr Fox either deliberately or recklessly shut his eyes to the source of Mr Cass's funds. That was sufficient to render the bank liable as a "knowing assistant".

The Court of Appeal unanimously agreed that Alliot J had been wrong to hold the bank liable as constructive trustee. There was no evidence adduced that the bank or its employees acted dishonestly. Furthermore, all members of the Court held that the bank had not been negligent in breach of its mandate with the solicitors. This finding necessarily precluded the bank being liable as a "knowing assistant" because negligence is the lowest point on the scale of possible mental states required for liability as a constructive trustee.

Despite reaching opposite findings on the facts, it is clear that Alliot J and the Court of Appeal agreed on the need for a want of probity in "knowing assistance" cases. May LJ in the Court of Appeal referred to Belmont Finance as being strong persuasive authority that nothing less than knowledge of an underlying dishonest design was sufficient to make a stranger a constructive trustee of the consequences of that design.

Whether the decision in Lipkin Gorman affords any satisfaction to innocent banks which become inadvertently involved in the dishonest conduct of a fiduciary is debatable. Lloyd's Bank will have derived some satisfaction, but an appeal to the House of Lords is pending. In the writer's view, the House of Lords should reject the imposition of liability on the bank because it did not have the requisite degree of knowledge to be a "knowing assistant". Confirmation is needed from the House of Lords that some want of probity is essential to this head of liability.

In one of the most recent cases, Agip (Africa) Ltd v Jackson,[39] Millett J emphasised that the true distinction in "knowing assistance" cases is between honesty and dishonesty. He stated,[40]

> There is no sense in requiring dishonesty on the part of the principal while accepting negligence as sufficient for his assistant. Dishonest furtherance of the dishonest scheme of another is an understandable basis for liability; negligent but honest failure to appreciate that someone else's scheme is dishonest is not.

It is submitted that this distinction is correct. If people fail to recognize fraud because their own moral obtuseness prevents them from doing so, they cannot be said to have acted dishonestly. Dishonest conduct involves failing to draw obvious inferences because they do not want to know the truth.

2.8 The Future

Constructive trusts are said to be imposed in equity in order to satisfy the demands of justice and good conscience.[41] Concepts of carelessness are less relevant to the demands of justice and good conscience than they are to determining whether liability attaches in tort or contract against a banker. As Harpum has noted,[42] under the Selangor

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[39][1989] 3 WLR 1367 The decision of Millett J has recently been upheld on appeal. See The Financial Times 18 Jan 1991.

[40]Above n39, 1389.

[41]Snell's Principles of Equity (26ed 1966), 201.

[42]Above n33, 152.

view the moral quality of a third party's action is not emphasised; instead attention is focused on the third party's failure to enquire or infer. This approach blurs the distinction between contract, tort and constructive trusts. If a banker has been negligent or careless then the law of tort and contract provide perfectly adequate remedies and there is no need to resort to equitable principles.[43]

It is suggested that Selangor is now of little persuasive authority on the subject of the bank as constructive trustee. Knowledge of types (iv) and (v) on the Baden Delvaux scale should no longer play a part in "knowing assistance" cases requiring a dishonest furtherance of fraud. The House of Lords now has the opportunity to resolve the debate once and for all in the appeal from Lipkin Gorman.

3 KNOWING RECEIPT

3.1 Categories of Liability

People who receive property which is subject to a trust become constructive trustees if they fall within one of three heads, namely:[44]

(i) that they received the trust property with knowledge that it was trust property and that the transfer to them was in breach of trust;

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[43] D Petkovic "The Banker as Constructive Trustee" [1989] 2 JIBL 88, 91.

[44] Above n7.

(ii) that having received the trust property knowing it to be such, but without knowledge of a breach of trust because there was none, they subsequently deal with the property in a manner inconsistent with the trust;[45] or

(iii) that although they received the trust property without knowledge of the trust, they were not bona fide purchasers for value without notice of the trust, and yet, after they had acquired knowledge of the trust they dealt with the property in a manner inconsistent with the trust.

3.2 Distinction Between Knowing Receipt and Knowing Assistance

The basic distinction between the two categories of constructive trust is that "knowing receipt" requires the stranger to receive the trust property, whereas "knowing assistance" does not. The second category arises where the third party assists the trustees in committing a breach of trust.

A more fundamental distinction is that in the "knowing receipt" class of case the underlying basis of the defendant's liability is the unjust enrichment of the defendant at the expense of the plaintiff. The defendant gains the trust property; the plaintiff is deprived of it. In the "knowing assistance" type of case the basis of liability is the conduct of the defendant in participating in a breach of trust. It is the behaviour of the

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[45] Above n7.

defendant which is regarded as unconscionable rather than the fact that the defendant gains a material advantage at the plaintiff's expense.[46]

Failure to appreciate this distinction has led to much confusion over the degree of knowledge a stranger must possess before being held liable as a constructive trustee.

3.3 Knowledge Required for Knowing Receipt

On Lord Selborne's formulation in Barnes v Addy[47] there is no need for a dishonest design on the part of the trustees to establish liability under this head. It has been argued, however, that there is no relaxation of the need for a want of probity by the stranger as a condition of liability. Hayton submits that on principle and precedent no distinction should be made between an innocent volunteer and a purchaser who merely has constructive notice - they only become liable when they obtain actual, "Nelsonian" (category (ii) on the Baden Delvaux scale) or "naughty" (category (iii) on the Baden Delvaux scale) knowledge that the property they hold is trust property or is its traceable product.

This view was taken in obiter dicta, by Sachs and Edmund-Davies LJJ in Carl Zeiss Stiftung v Herbert Smith & Co (No 2),[48] and the point was re-stated by Megarry V-C in Re Montagu's Settlement Trusts.[49] Megarry V-C held that to impose upon a stranger the burden of personal liability to account as a

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[46] Powell v Thompson (1990) 1 NZ ConvC 190,663; 190,670.

[47] Above n6.

[48] [1969] 2 Ch 276.

[49] [1987] Ch 264.

constructive trustee, the stranger's conscience must be sufficiently affected to justify the imposition of such liability. He stated that:[50]

> ... the cold calculus of constructive and imputed notice does not seem an appropriate instrument for deciding whether a man's conscience is sufficiently affected for it to be right to bind him by the obligations of a constructive trustee.

Megarry V-C thus rejected the view that constructive notice suffices for "knowing receipt" cases as propounded by Peter Gibson J in Baden Delvaux. He restricted liability under this head to cases involving knowledge of types (i) to (iii) on the Baden Delvaux scale.

With respect, His Honour has misinterpreted the basis for liability as a "knowing recipient". Whether or not the stranger's conscience has been affected is irrelevant to this category of liability. The stranger is made liable, not because he has acted in an unconscionable manner, but because he has been unjustly enriched at the plaintiff's expense. The fact that moral improbity cannot be shown in every case of "knowing receipt" is immaterial. What liability under this head purports to do is to recognize the vulnerability of beneficiaries and not to compound their problems by accepting low standards of care in strangers' dealings with their principals.[51] To achieve this aim, it is submitted that all five categories of

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[50] Above n49, 273.

[51] JK Maxton "Equity" [1990] NZ Rec LR 89, 94.

knowledge on the Baden Delvaux scale ought to be sufficient to impose liability on a stranger as a "knowing recipient". If the focus is on the unjust enrichment of the defendant, it should not matter whether that defendant had actual knowledge or just constructive notice of the breach of trust.

This view is supported by several recent cases. In Belmont Finance Corporation Ltd v Williams Furniture Ltd (No 2)[52] Goff LJ stated that to receive trust funds in such a way as to become accountable for them did not depend on fraud or dishonesty. Similarly, in International Sales and Agencies Ltd v Marcus[53] Lawson J considered that a recipient of company funds transferred in breach of a director's fiduciary duties could be held liable to account upon actual knowledge or constructive notice of the breach. He found actual knowledge on the facts, although he considered it would have been sufficient if the ordinary reasonable person in the position of the defendant would have known of the breach.

The basis of liability in "knowing receipt" and "knowing assistance" cases is quite different. There is no reason why the degree of knowledge required for liability should be the same and there is good reason why it should not.[54]

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[52] [1980] 1 All ER 393.

[53] [1982] 3 All ER 551.

[54] Agip v Jackson [1989] 3 WLR 1367.

4 THE LAW IN NEW ZEALAND

4.1 Knowing Receipt

Only a few cases in New Zealand have dealt with the personal liability of a stranger as constructive trustee under either the "knowing receipt" or "knowing assistance" headings. Most of the findings have been made by way of obiter dicta, leaving the legal position of third parties to a trust such as banks in a state of uncertainty.

The main authority is the Court of Appeal's decision in Westpac Banking Coporation v Savin.[55] The two plaintiffs, Savin and Boyle, had authorised a boatyard operator Aqua Marine to sell their boats on a commission basis. Aqua Marine sold the boats and then deposited the money received from the purchasers into its trading account at Westpac which was overdrawn.

Neither vendor was paid. Several weeks after the sales Aqua Marine went into liquidation and there were no funds available to meet the claims of ordinary creditors. Savin and Boyle sued Aqua Marine and Westpac alleging breach of fiduciary duty and conversion. They also alleged breach of constructive trust by Westpac, which is the relevant claim for present purposes.

The breach of fiduciary duty by Aqua Marine was established early on. It had no authority to blend the vendors' money with its own and apply the balance for its private or trading purposes. Less still could it pay the money into a bank account which was overdrawn.

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[55] [1985] 2 NZLR 41.

In the High Court, Holland J dealt with the claim against Westpac under the "knowing assistance" head of liability. He found that by receiving the cheques and crediting them to Aqua Marine's overdraft, Westpac assisted the company with knowledge of a dishonest and fraudulent design on the part of the company. This finding was subject to a strong challenge by Westpac on appeal.

The preliminary conclusion reached by Richardson J in the Court of Appeal was that a bank would not be permitted to profit through a misapplication by a customer of funds entrusted to the customer if it had notice of the breach of fiduciary duty. However, the vital question was what, if anything short of actual knowledge that the depositor was committing a breach of fiduciary duty, is sufficient to impose on the bank personal liability to account as a constructive trustee.

Without explaining his reason for taking a different approach from Holland J, Richardson J dealt with the claim against Westpac under the "knowing receipt" and not the "knowing assistance" head. His Honour cited Baden Delvaux and then stated:[56]

> As will shortly becom apparent, it is not necessary for the purpose of this case to express a final view as to the ambit of constructive knowledge in this class of case. In principle I cannot see any adequate justification for excluding categories (4) and (5) at least in the "knowing receipt" class of case and I tend to favour for that class of case the comprehensive approach adopted by Peter Gibson J which now has the endorsement of Halsbury.

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[56] [1985] 2 NZLR 41.

His Honour was not required to express a final view as to the requisite degree of knowledge because he found that the actual knowledge of the bank was such that in receiving the cheques and applying them in reduction of the overdraft, it wilfully shut its eyes to the obvious (category (ii) knowledge) or, at least, wilfully and recklessly failed to satisfy itself that the receipts were not in respect of "on behalf" sales (category (iii) knowledge). Therefore, it was unnecessary to decide whether constructive notice sufficed for the "knowing receipt" head, although Reichardson J favoured its acceptance.

While McMullin J was content to agree with Richardson J on this point, Sir Clifford Richmond undertook a comprehensive review of the English cases dealing with the two heads of liability. In Sir Clifford Richmond's opinion, the law was correctly stated in Belmont Finance Corporation Ltd v Williams Furniture Ltd (No 2)[57] where the court held that actual knowledge or constructive notice is sufficient to impose liability on a stranger for "knowing receipt". Therefore, agreeing with Richardson and McMullin JJ, His Honour concluded that Westpac be held liable to account to the plaintiffs as a constructive trustee.

In Attorney-General for the United Kingdom v Wellington Newspapers Ltd[58] Davison CJ also followed Belmont Finance Corporation Ltd (No 2) in holding that constructive notice suffices for liability as a "knowing recipient". The same conclusion was reached by Tomkins J in Marr & Anor v Arabco Traders Ltd & Ors.[59]

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[57] Above n52.

[58] [1988] 1 NZLR 129.

[59] (1987) 1 NZBLC 102, 732.

As the writer has already suggested, the acceptance of constructive notice for liability as a "knowing recipient" can be justified pursuant to the underlying basis of this head of constructive trust, namely the inequity of the defendant retaining the benefit of property received at the plaintiff's expense, rather than the conduct of the defendant.

This point was emphasised by Thomas J in Powell v Thompson.[60] His Honour stated that the danger of stipulating a test which was too high in the "knowing receipt" class of case is that a court of equity will be unable to intervene to assist an innocent plaintiff where, in the overall circumstances, it might consider such assistance justified.[61] He therefore considered that the knowledge required should be no greater than necessary to permit the court to examine the circumstances of the case with a view to deciding whether the defendant's retention of the trust property is inequitable.

On that basis, Thomas J held that the five categories of knowledge on the Baden Delvaux scale apply to a person charged with being a "knowing recipient." His Honour would, however, have deleted reference to the word "honest" in the phrase "honest and reasonable person" because dishonesty is not a necessary ingredient if a constructive trust founded on unjust enrichment is in issue.[62]

Even though unjust enrichment and "property" are the foci of Thomas J's analysis, His Honour nevertheless did require some knowledge by the defendant before liability could be imposed. This

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[60](1990) 1 NZConvC 190, 663.

[61]Above n60, 190,671.

[62]Above n60, 190,672.

view differs from Birks, who suggests that where an innocent recipient can be held to make restitution, there is a persuasive argument that liability should be strict.[63] Thomas J appears, in fact, to have recognised the attractiveness of such a position, as indicated in the following comment:[64]

> I would not preclude the possibility that in certain circumstances a court of equity could be persuaded to examine the equities of the competing claims where the defendant was not aware that he or she was receiving or dealing with the property in a way which was inconsistent with a trust. Because liability in this class of case stems from equity's unwillingness to accept the enrichment of the third party at the expense of the beneficiary, and not any particular conduct or misconduct on the part of either the trustee or the third party, such knowledge may not be necessary in order to activate equity's jurisdiction with the objective of ensuring a result which is consonant with good conscience.

The difficulty with Birk's analysis is that it assumes that the recipient of a mistaken payment should be obliged to make restitution in every case. This undermines any consideration of whether the defendant has been unjustly enriched. If unjust enrichment is to be the focus in "knowing receipt" cases, the knowledge of the defendant will necessarily be one factor in determining whether the benefit gained is unjust. Furthermore, as Professor Rickett points out,[65] if strict liability is applicable to the

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[63] "Misdirected Funds: Restitution from the Recipient" (1990) Lloyd's Mar & Com LQ 296.

[64] Above n60, 671.

[65] "Strangers as Constructive Trustees" (1991) 5 BCB 245, 247.

"knowing receipt" case, what is the difference between this case and a simple case for equitable tracing?

4.2 Knowing Receipt and Equitable Tracing

Restitutionary rights and remedies can be personal or proprietary. A proprietary remedy recognizes that the plaintiff has some sort of ownership interest in an identifiable asset such that, with some exceptions, he or she can sue anyone else who controls it but who refuses to surrender it. A personal remedy, on the other hand, results not from ownership of an asset but from a breach of an obligation which the particular defendant owes the plaintiff.[66]

The difference is important because not only does it mean that plaintiffs who have proprietary remedies may have the ability to recover property for which they have a sentimental attachment, but also their rights to sue anyone controlling the asset will protect them from the insolvency of intervening possessors of the asset.[67]

The imposition of constructive trusteeship as a personal remedy is quite distinct from the proprietary right of equitable tracing. However, despite the advantages proprietary remedies have over personal ones, the courts have often ignored tracing where it was clearly available on the facts, resorting instead to a constructive trust. In Westpac v Savin,[68] for example, Westpac used the

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[66]Kos and Watts "Unjust Enrichment" NZLS Seminar, Feb 1990, 33.

[67]Above n66.

[68]Above n55.

money received to reduce Aqua Marine's overdraft, leaving it in an identifiable form. On that basis it is suggested that an equitable tracing claim would have succeeded against the bank. Although the common law has traditionally limited its proprietary rights to those relating to tangible assets other than money, courts of equity have allowed tracing claims in respect of money deposited in a bank account.[69] The possibility of tracing was not even considered in the Westpac case, all the argument being centred around the personal liability of constructive trusteeship.

4.25 Deciding on the Appropriate Action

In the writer's opinion, the imposition of constructive trusteeship on strangers as a formula for equitable relief is inappropriate where the strangers still have the trust property or its traceable product in their hands. This situation is better dealt with under the law of property and not under the law of personal remedies. The appropriate action is either a common law or equitable tracing claim. Common law tracing is merely an evidential requirement, used as a stepping stone to an action for money had and received, or conversion. Where common law tracing is not available on the facts, an equitable tracing claim should be pursued. The appropriate remedy in this situation will be an order for specific restitution. It does not come within the sphere of unjust enrichment at all, being a pure proprietary claim.

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[69] See Sinclair v Brougham [1914] AC 398.

A personal remedy in the form of a constructive trust is only appropriate for restitution from a recipient against whom tracing has become impossible. It is submitted, however, that this class of case is better dealt with under the "knowing assistance" and not the "knowing receipt" head of liability. By dissipating the proceeds the recipient has assisted the fraud of the trustees and should be held personally liable to account if he had one of the first three types of knowledge on the Baden Delvaux scale. Selangor and Karak provide recent examples of banks being held liable within the "knowing assistance" category even though they received the trust property.

Even in this second situation, the court is not necessarily considering a restitutionary proprietary claim, ie the imposition of a constructive trust. It is simply a question of translating the tracing claim into a personal claim. Whether or not that claim should be met by the grant of a restitutionary remedy will depend on whether or not the property remains identifiable. Only if it does not will the restitutionary issue arise and the stranger be held personally liable to account for the value of the property. The constructive trusteeship tag given to the "knowing receipt" head of liability is regrettable.[70]

Given that the law of priorities and tracing are available to provide proprietary remedies against the recipient, the need for an additional head of recovery in the form of personal liability is surely questionable, even more so if strict liability is now applicable to the "knowing receipt" category.

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[70] R Fardell & K Fulton "Constructive Trusts - A new era" [1991] NZLJ 90, 101.

Pursuant to this form of liability, a court will require any property transferred in breach of trust to be returned to its rightful owner, regardless of the knowledge of the defendant. In that case there is no need for the "knowing receipt" category at all.

In the writer's opinion, the "knowing receipt" head of constructive trust should be abandoned. Courts should instead deal with claims using priority and tracing principles. Where tracing is not possible, personal liability should be based on the "knowing assistance" category. The result would be a significant improvement in the sense and clarity of the law.

4.3 Knowing Assistance

As yet, there has been no authoritative decision in New Zealand settling the degree of knowledge required under the "knowing assistance" head of liability. In Westpac v Savin[71] Sir Clifford Richmond expressed an obiter view; he did not find it necessary to give a final opinion as to the degree of knowledge required because he dealt with the case under the "knowing receipt" head of liability. However, he was strongly in favour of the view taken by the English Court of Appeal in Belmont Finance Corporation Ltd (No 1),[72] namely that some want of probity on the part of the stranger is essential. Tomkins J accepted this approach in Marr's case. He held that the plaintiffs would have to establish either actual, "Nelsonian", or "naughty" knowledge to make the defendant liable as a "knowing assistant".

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[71] Above n55.

[72] Above n36.

In Powell v Thompson,[73] however, Thomas J could find no sound reason why the negligent conduct of a third party who assisted the trustee to commit a breach of trust should be put beyond the purview of unconscionable conduct which should attract the burden of trusteeship.[74] His Honour held that the issue under this head of liability is whether or not the third party's conduct is "unconscionable". He concluded that:[75]

> ... the requisite knowledge is not confined to actual knowledge but may include constructive knowledge. The third party's failure to make an enquiry notwithstanding that an enquiry might reasonably have been expected will form part of the defendant's overall conduct which will be examined by the court. Thus, where the third party facilitates a breach of trust without knowing of all the facts constituting the breach or knowing of the trustee's devious intention, the question will be whether, in all the circumstances, his or her conduct was unconscionable and justifies the imposition of the obligations of the trust upon them.

Thomas J provided several reasons in support of this general unconscionability test. First, His Honour expressed a need to ensure that equity moves with the times. He observed that the Selangor case encouraged flexibility of approach. Although noting that recent English decisions had repeatedly upheld the dishonesty requirement, Thomas J went on to say that the New Zealand Court of Appeal had not endorsed

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[73] Above n60.

[74] Above n60, 190,675.

[75] Above n60, 190,674.

this approach.[76] It was felt that Sir Clifford Richmond's opinion in the Westpac case was in the nature of obiter dicta and could even have been a reference to the situation where strangers receive trust property in their capacity as agents.

Secondly, His Honour stated that the dishonesty requirement overlooks that equity is concerned to control unconscionable behaviour. In his view it did not matter whether the trustee's conduct was fraudulent or negligent. Once a breach of trust involving a third party has been committed, the issue which arises is between the beneficiary and that third party. If the third party's conduct has been unconscionable, then he or she is liable to account to the beneficiary, irrespective of the degree of improbity in the trustee's conduct.[77]

Finally, in Thomas J's view there is a difference between the approach to constructive trusts of the English courts on the one hand and of the New Zealand and Canadian courts on the other. The English courts see the constructive trust as a substantive institution and accordingly, it is available in relatively few situations. In contrast, His Honour stated that the constructive trust is viewed by New Zealand courts as a device for imposing liability to account and as a broad equitable remedy for reversing unconscionability.[78]

With respect to Thomas J, his judgment on this point represents a departure from decided authority and can be challenged on several grounds. First, Sir Clifford

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[76] Above n60, 190,675.

[77] Above n60, 190,767.

[78] Above n60, 190,677-8.

Richmond's judgment in the Westpac case cannot be read in any way other than as an endorsement of the restricted knowledge approach to the "knowing assistance" head of liability. Although Sir Clifford's views on this matter were obiter dicta, they should be regarded as very persuasive. His Honour was not referring to agents when he supported the requirement of a want of probity. Furthermore, Thomas J's decision is in conflict with Tomkin J's earlier decision in Marr's case.

Thomas J's second reason noted above is also in conflict with earlier authority. The reason seems to result from some confusion on Thomas J's part concerning the dishonesty requirement. The English authorities have always been clear that the threshhold for the application of the "knowing assistance" head of liability is a dishonest and fraudulent design on the part of the trustees. What has been in dispute is whether the same threshhold applies to the third party involved in the breach of trust. It must be remembered that it is not the trustees who are being made liable, but the person assisting the trustees. That person has not received any trust property. Consequently, the assistant will not have accepted any fiduciary responsibilities and any judgment will be met from personal resources, not from any benefits received. The dishonesty requirement adopted by the English courts reflects a desire to restrict liability for breaches of fiduciary duty to the fiduciaries themselves.[79] Those who do not have the means of controlling a fiduciary's behaviour should only be liable in limited circumstances, namely where they have acted dishonestly.

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[79] Above n70, 102.

In terms of policy, there is a persuasive argument that the dishonesty requirement is the only practical option for "knowing assistance" cases. The inevitable result of Powell will be to place a higher standard of enquiry on institutions such as banks. How the funds have been generated will be a familiar question between bankers and their clients. This is unacceptable.

5 THE CONTRACTUAL RELATIONSHIP BETWEEN BANKER AND CUSTOMER

5.1 The Bank's Conflicting Duties

A bank is not normally trustee of its customers of the amount standing to their credit in their bank accounts. The predominant relationship is that of debtor and creditor.[80] It is important, therefore, to determine what effect this contractual relationship has on the imposition of a constructive trust on the bank.

In Lipkin Gorman v Karpnale[81] Alliot J accepted five propositions on behalf of Lloyd's Bank which dealt with this question:[82]

(i) The bank is entitled to treat the customer's mandate at its face value except in extreme cases.

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[80] Foley v Hill (1848) 2 HL Cas 28 Recently reaffirmed in Tai Hing cotton Mill Ltd v Liu Chong Hing Bank Ltd [1985] 2 All ER 947.

[81] [1987] 1 WLR 987.

[82] Above n81, 1006

(ii) The bank is not obliged to question any transaction which is in accordance with the mandate unless a reasonable banker would have grounds for believing that the authorized signatories are misusing their authority for the purpose of defrauding their principals or otherwise defeating their true intention.

(iii) Accordingly, if a bank does not have reasonable grounds for believing there is a fraud, it must pay.

(iv) In assessing this, 'mere suspicion or unease' does not constitute reasonable grounds and is not enough to justify a bank in ignoring its customer's mandate.

(v) It follows that the bank is not obliged "to act as an amateur detective."

Paget's Law of Banking points out[83] the ambivalent nature of bankers' duties when they know that the account is a trust account. They have to consider the interests of the persons beneficially entitled and they have to recognize the right of the customer to draw cheques on the account and have them honoured.

This dual duty necessarily makes the task of bankers difficult. On the one hand, if they fail to honour the customer's mandate, they may render themselves liable for breach of contract; on the other, if they follow an instruction tainted by fraud, they may be liable as a constructive trustee.[84] It has been rightly suggested,[85] therefore, that the English

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[83](1982,9thed)69.

[84]LJW Aitken "Bank's Liability as Constructive Trustee" [1989] 3 BLB 62, 63.

[85]Petkovic, Above n43.

Court of Appeal's decision to limit the degree of knowledge required for liability under the "knowing assistance" head accords with commercial reality. To impose a duty to enquire does not accord well with the requirement that bankers perform banking transactions promptly. If performing routine banking functions could constitute "knowing assistance" in cases where a banker acts honestly, merely because the banker is in possession of facts which would lead an honest and reasonable person to infer a breach of trust or put such a person on enquiry of a breach of trust, the performance of the contract between banker and customer would be unjustifiably disrupted.[86]

5.2 Protecting Banks from Liability

A recent case in which a bank successfully argued that it was entitled to refuse its customer's instructions is Manus Asia Company Inc. v Standard Chartered Bank.[87] The defendant, Standard Chartered Bank, refused to transfer monies to the plaintiff customer. The customer was a company controlled by a person called Lee. Lee had been involved in certain activities in the United States which were under investigation by the Federal authorities as being "insider dealing". Profits from these activities were placed into the hands of the defendant bank. Subsequently, the customer asked for the monies to be transferred into the Hong Kong branch of that bank. The defendant bank refused so the customer brought proceedings against it for breach of contract.

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[86] Above n85.

[87] (1988) Hong Kong Current Law, K7.

It is well established as a result of the decision in Libyan Arab Foreign Bank v Bankers Trust Company[88] that the customer has the fundamental right to demand payment in cash of the amount standing to the credit of the customer's account. The case provides one possible defence for a bank which refuses to comply with its customer's instructions, namely that payment to the customer would render the bank liable as a constructive trustee to a third party.

Standard Chartered Bank had actual knowledge of Lee's dishonest and fraudulent scheme which was in breach of United States law. It was for this reason that it had placed the monies in its own foreign account. Therefore, if the bank had transferred the funds to the plaintiff company it would have been personally liable to account for the value of the funds as constructive trustee. As a result, the Court held that the bank had not breached its contract with the company.

The decision in this case provides some relief, at least, for banks caught between their contractual duties to customers and their responsibility to third party beneficiaries. However, to decide not to honour otherwise proper instructions because of a suspicion that fraud is occurring imposes an onerous duty on a bank in relation to potential breach of contract, breach of confidence, and defamation.

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[88] [1989] 3 All ER 252.

6 THE REMEDIAL CONSTRUCTIVE TRUST

6.1 What is a Remedial Constructive Trust?

The remedial constructive trust was developed in Canada over a decade ago. It was introduced to remedy situations of unjust enrichment in de facto relationship cases,[89] but has recently been extended into the commercial arena.[90]

A plaintiff who requests a remedial constructive trust seeks a declaration that he has a beneficial interest in specific property owned by, or in the possession of, a defendant who has been unjustly enriched by that ownership or possession. If successful, the relief that the plaintiff obtains is proprietary in the sense that it gives the successful plaintiff rights in the specific property which are good not only against the defendant, but also against the general creditors of the defendant.[91]

It must be emphasised that this form of constructive trust is remedial in nature. If the court is asked to grant such a remedy and determines that a declaration of constructive trust is warranted, then the proprietary interest awarded will be deemed to have arisen at the time when the unjust enrichment first occurred.[92]

Despite being described as a "broad and flexible equitable tool",[93] the remedial constructive trust

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[89] Murdoch v Murdoch (1973) 41 DLR (3d) 367.

[90] Atlas Cabinets & Furniture Ltd v National Trust Co Ltd (1988) 50 DLR (4th) 159 (Supreme Court) and (1990) 68 DLR (4th) 161 (Court of Appeal).

[91] DM Paciocco "The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors" (1989) 68 Can Bar Rev 315.

[92] Rawluk v Rawluk (1990) 65 DLR (4th) 161, 177.

[93] Pettkus v Becker (1980) 117 DLR (3d) 257, 270

has developed on a principled basis. Before a court considers whether to award this remedy it must make a finding that there has been an unjust enrichment according to the formula adopted by the majority in Pettkus v Becker.[94] This requires the court to find that there has been:

(i) an enrichment of the defendant;

(ii) a corresponding deprivation experienced by the plaintiff; and

(iii) the absence of any juristic reason for the enrichment.

As Paciocco points out,[95] this principled basis is important because the remedy confers a beneficial interest in the property which is made the subject matter of the trust. This has the effect of giving the plaintiff the status of a secured creditor with respect to the constructive trust property. This status is not warranted in every case of unjust enrichment.[96]

The remedial constructive trust differs from the traditional English concept in several respects. The first is its foundation in the concept of unjust enrichment. As Professor Waters puts it:[97]

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[94] Above n93, 273-274.

[95] Above n91, 318.

[96] For a discussion of the implications of the remedial constructive trust on insolvency, see DM Paciocco "The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors" (1989) 68 Can Bar Rev 315, 321-325.

[97] Law of Trusts in Canada (2ed,1984)385.

> ... though the constructive trust remains in common law Canada a collection of liability situations, it now has a theme. The constructive trust in the area of spousal, or quasi-spousal property 'arises ... out of inequitable withholding resulting in an unjust enrichment', and this is the theme, the basis of the defendant's liability.

In contrast to the "knowing assistance" head of liability, the conduct of the defendant is only relevant to the remedial constructive trust in determining whether the enrichment is unjust. Even where a defendant is innocent, there may be no reason why that defendant should enjoy the increase in the value of property to which the plaintiff has a compelling restitutionary claim.[98] Furthermore, the unconscionability or otherwise of the defendant's conduct has no bearing on the justification for awarding the plaintiff priority over the general creditors of the defendant.

The second main difference between the traditional English concept of constructive trust and the doctrine now accepted in Canada is the proprietary nature of the Canadian doctrine. The remedial constructive trust confers a beneficial interest on the plaintiff with respect to the property held by the defendant. This can be distinguished from the "knowing assistance" and "knowing receipt" heads of liability, which are merely personal remedies and hold the defendant liable to account for the value of the trust property.

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[98] Above n91,348.

6.2 Equitable Tracing: Its Relationship to the Remedial Constructive Trust

Like the remedial constructive trust, equitable tracing provides the plaintiff with the specific recovery of property. The remedy of tracing has traditionally only been available where the plaintiff holds a beneficial interest in the property and where the property remains in the defendant's hands. The prerequisite of a beneficial interest has two aspects. First, it means that the plaintiff must have a proprietary interest in the property. Secondly, that proprietary interest must be equitable. Each of these aspects is satisfied where the property is held on behalf of the plaintiff by someone who stood in a fiduciary relationship to the plaintiff.

Both of these requirements are inappropriate for consideration as guiding principles in the context of the remedial constructive trust. Given that the formula for identifying unjust enrichment is intended to identify restitutionary proprietary claims, the requirement of a "pure" proprietary interest in the beneficiary is irrelevant to the imposition of a remedial constructive trust. Even though the proprietary interest awarded is deemed to have arisen at the time when the unjust enrichment first occurred, in reality it comes into existence as a result of the imposition of the trust.[99]

As a result of the decision in Pettkus v Becker,[100] the fiduciary requirement is also no longer necessary for a remedial constructive trust. The importance

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[99] Above n91, 330.

[100] Above n93.

of this case was emphasised in Hunter Engineering Company v Syncrude Canada Ltd[101] where Dickson CJC stated:[102]

> The constructive trust has existed for over two hundred years as an equitable remedy for certain forms of unjust enrichment ... Until the decision of this court in Pettkus v Becker, the constructive trust was viewed largely in terms of the law of trusts, hence the need for the existence of a fiduciary relationship. In Pettkus v Becker, the court moved to an approach more in line with restitutionary principles by explicitly recognizing constructive trust as one of the remedies for unjust enrichment.

It is clear, therefore, that the remedial constructive trust is quite different from the doctrine of equitable tracing. The two main requirements for tracing - a "pure" proprietary interest in the plaintiff and a fiduciary relationship - are not prerequisites for the imposition of a remedial constructive trust.

6.3 The Commercial Setting

> It is one thing to apply the remedy of constructive trust or analogous remedies to relationships such as husband and wife where, in common human experience, the parties

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[101](1989) 57 DLR (4th) 321.

[102]Above n101, 348-349.

> rely at the outset on affection as a guarantee of reward and quite another to apply such remedies to relationships which, in the reasonable expectations of their participants, are governed by bargains clearly made with the intention of creating legal obligations on both sides.[103]

This passage represents the traditional view of the judiciary, which has regarded unfavourably the intrustion of equity into commercial relationships. Even today, many judges are reluctant to impose equitable obligations on commercial representatives because of what they see as the need for certainty in commercial transactions.[104]

One particular criticism made of the application of equitable doctrine in commercial transactions is that equity tends to view the case essentially as a problem between the immediate parties to the particular transaction and that, on occasions, insufficient attention is paid to the more remote consequences of a decision.[105]

This criticism is very applicable to the situation where a constructive trust is imposed on an institution such as a bank. In most cases the court will not be assisted in its determination by a "commercial impact statement" which sets out the potential ramifications of imposing a duty to enquire on bankers. As the writer pointed out earlier,[106]

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[103] Atlas Cabinets & Furniture Ltd v National Trust Co Ltd (1990) 68 DLR (4th) 161, 196 (per Southin JA, dissenting in part).

[104] See eg Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (1983) QB 529, 540-541.

[105] See eg Hewett v Court (1983) 149 CLR 639, 651.

[106] Above, para 5.1.

such a duty is of serious concern to banks. However, this concern was recognised in the Westpac case. Richardson J said:[107]

> Clearly Courts would not readily import a duty to inquire in the case of commercial transactions where they must be conscious of the seriously inhibiting effects of a wide application of the doctrine. Nevertheless there must be cases where there is no justification on the known facts for allowing a commercial man who has received funds paid to him in breach of trust to plead the shelter of the exigencies of commercial life.

Although the remedial constructive trust developed in the family law context, it has recently been applied in a commercial setting. In Atlas Cabinets & Furniture Ltd v National Trust Company Ltd[108] the plaintiffs were contractors on a condominium project which was financed by the defendant trust company. When the owner ran into financial difficulties, the contractors became concerned and threatened to reduce their work-force. However, the defendant's mortgage manager assured them that the defendant would continue to make advances and that it was retaining a hold-back. On the strength of those representations, the plaintiffs completed the project. However, when the contractors were not paid by the owner, the defendant claimed that it retained the money solely for its own security. The plaintiffs claimed the balance in the hold-back.

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[107] Above n55, 53 .

[108] Above n90.

The majority in both the British Columbia Supreme Court and Court of Appeal held that a remedial constructive trust could be imposed on the defendant. In the circumstances, the defendant was enriched because the project was completed, and the plaintiffs were deprived in that they extended further money to the project. Finally, there was no justification for the enrichment.

In the Court of Appeal, Lambert JA expressly recognised the need to distinguish between domestic and commercial relationships. His Honour stated that in a domestic relationship, equality of parties should normally be the standard of fairness, but that in a business relationship, honest dealing and not equal dealing should set the standard of fairness.[109] In Lambert JA's opinion, the concept of the injustice of the enrichment as being against sound commercial conscience should guide the application of the three tests in Pettkus v Becker when they are applied to a commercial relationship.[110]

As Paciocco points out,[111] courts should be much more inclined to order specific relief in the context of spousal disputes, and must less inclined to do so in commercial cases. There are compelling reasons for this distinction. In the spousal context, the parties enter into a social partnership where there are expectations that both life and life-style will be shared. Relationships are ordinarily based upon a personal committment that is initially intended by the parties to be permanent. As a result, spousal relationships are typically established

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[109](1990) 68 DLR (4th) 161, 171.

[110]Above n109, 172.

[111]Above n91, 325-326.

and maintained with little formality, and little real negotiation about how property is to be divided in the event of dissolution. The fair treatment of the parties to such relationships has broad social policy implications which go beyond the usual commercial considerations.[112]

In the commercial context, however, parties are expected to protect their interests contractually. If there are partnership or acquisition of title expectations it is anticipated that these will be provided for specifically. Moreover, plaintiffs must overcome the traditional protection of third parties from undisclosed charges, as evidenced by the bona fide purchser for value without notice rule. Reasonable investigation is less likely to reveal an unjust enrichment arising in the commercial sphere than in the domestic sphere.[113]

It follows that whereas there are strong reasons for the ready invocation of the remedial constructive trust in cases of the unjust enrichment of a spouse, competing considerations counsel caution in the commercial context.

6.4 The Remedial Constructive Trust in New Zealand

In Elders Pastoral v Bank of New Zealand[114] the New Zealand Court of Appeal indicated that the constructive trust can be used as a general remedy for imposing liability to account on persons who cannot in good conscience retain a benefit in breach of their legal or equitable obligations.

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[112] Above n91, 327.

[113] Above n91, 327-328.

[114] [1989] 2 NZLR 180.

In that case the BNZ loaned, to a Mr Gunn, money secured over his stock by an instrument by way of security registered under the Chattels Transfer Act 1924. Implied into the instrument was a clause to the effect that Mr Gunn would not, without the written consent of the bank, sell any part of the stock except in the ordinary course of business. Clause 15 of the instrument further provided that, in the absence of any direction to the contrary by the bank, all money payable in respect of the sale of stock should be paid to the bank.

Mr Gunn's stock agents, Elders Pastoral Ltd, sold some of the stock secured and retained most of the proceeds of sale for itself in satisfaction of a debt owed to it by Mr Gunn. Only a small balance remaining was paid to the bank. The bank sued Elders to recover the full amount. Elders maintained that clause 15 had only contractual force between Mr Gunn and the bank, and did not give the bank an interest in the proceeds of sale, nor any right to trace the proceeds against a party in the particular position of Elders.

The Court of Appeal accepted that Elders was taking a stand on what it believed to be its legal rights. Its good faith was not in question during the proceedings (ie there was no want of probity on its part). Nevertheless, the Court held that, on any objective test, Elders had a less than conscionable claim to retain the money.

Cooke P concluded that reasonable persons in the shoes of all three parties would naturally have

thought that Elders must have held the net proceeds for the bank to the extent of Mr Gunn's indebtedness to the bank, unless the bank directed or agreed otherwise. He stated:[115]

> As a matter of fair commercial dealing one can hardly imagine any reasonable party in any of the three positions, on giving thought to their relationship, having any doubt about the duty.

Therefore, it seemed to His Honour to be a clear case for imposing a constructive trust. In short, His Honour did not think that in good conscience Elders could retain the money.

The most important aspect of this case is that the Court of Appeal was prepared to impose a constructive trust without finding that a fiduciary relationship existed between the Bank of New Zealand and Mr Gunn. Both Cooke P and Somers J found that all that was needed was for the plaintiff to show that it would be "against good conscience" for the defendant to retain the asset in the face of the plaintiff's claim. Somers J had in fact already found that there was an obligation "fiduciary in character"[116] between the parties imposing a duty to account for the proceeds of sale.

However, it is unclear in the case whether the removal of the fiduciary requirement relates to the constructive trust, equitable tracing, or both. At one point in His Honour's judgment, Somers J referred to constructive trusts and equitable tracing

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[115] Above n114, 186.

[116] Above n114, 192.

when discussing the need for a fiduciary relationship.[117] This confusion has been compounded in decisions following Elders. In Mogal Corporation Ltd v Australasia Investment Company Ltd[118] Smellie J considered that in Elders the Court of Appeal took the view that a fiduciary relationship is no longer a necessary prerequisite for a constructive trust.[119] But in Re Goldcorp Exchange Ltd (in rec) and Goldcorp Refiners Ltd (in rec)[120] Thorp J concluded that despite recent authorities holding that a fiduciary relationship is a condition precedent to obtaining an equitable proprietary right of tracing, Elders had settled the law for New Zealand the other way.[121]

As the writer pointed out earlier,[122] the imposition of constructive trusteeship as a personal remedy is quite distinct from the proprietary right of equitable tracing. The imposition of constructive trusteeship on a third party is inappropriate where the third party still has the trust property or its traceable product in its hands. As Elders still retained the proceeds from the sale of the stock, the appropriate action was a tracing claim. However, while mentioning tracing, the Court of Appeal appeared also to impose a personal obligation on Elders to account for the proceeds of sale to the BNZ as constructive trustee.

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[117] Above n114, 193.

[118] (1990) unrep,CL70/87 Auckland.

[119] Above n118, 64.

[120] (1990) unrep, M1450/88, M1332/89, M1572/89, CP21/88 Auckland; CP498/89 Christchurch.

[121] Above n120, 109.

[122] Above, para 4.2.

The "good conscience" constructive trust developed by the Court of Appeal in Elders has several features similar to Canada's remedial constructive trust. First, it appears to be based on unjust enrichment principles. The Court's focus in Elders was on the fact that the defendant had received a benefit to which it was not entitled, consequently depriving the plaintiff of that benefit. Secondly, the Court's finding that the defendant could not in good conscience retain the benefit equates with the third limb of the remedial constructive trust, namely that there must be no juristic reason for the enrichment. Furthermore, in both jurisdictions the courts have removed the requirement of a fiduciary relationship. This accords with restitutionary principles, where the concern is not with the nature of the relationship between the parties, but rather with remedying the resultant unjust enrichment.

The Court of Appeal's "good conscience" constructive trust does, however, differ in two important respects from the remedial constructive trust. First, the remedial constructive trust is a proprietary remedy and confers a beneficial interest on the plaintiff with respect to the property held by the defendant. In contrast, the "good conscience" constructive trust only gives the plaintiff a personal remedy, holding the defendant liable to account for the value of the property.

Secondly, and perhaps more importantly, the "good conscience" constructive trust is a substantive claim in itself, whereas the remedial constructive trust is merely one of the remedies available

for unjust enrichment. Canadian courts have a two-step approach to the cases. Primarily, they must find that the defendant has been unjustly enriched at the expense of the plaintiff according to the formula in Pettkus v Becker.[123] Then, and only then, can they consider a suitable remedy, which is the point at which the remedial constructive trust becomes relevant. It is submitted that this is more advantageous than the approach taken by the New Zealand Court of Appeal. If, as in Elders, the court's focus is to be on the benefit derived by defendants to which they are not entitled, then the restitutionary approach adopted in Canada would provide New Zealand courts with the flexibility to grant plaintiffs an appropriate remedy. At present this flexibility is not permitted by the substantive constructive trust.

7 CONCLUSION

7.1 The Future for New Zealand

In the writer's opinion, New Zealand should move away from the English substantive constructive trust concept of "knowing receipt" towards the remedial constructive trust developed in Canada. The New Zealand Court of Appeal has already indicated in Elders its willingness to use the constructive trust as a general equitable remedy. However, the "good conscience" constructive trust developed in that case is still too restrictive. Restitutionary principles require courts to find appropriate

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[123] Above n93.

remedies in cases of unjust enrichment. This can only be achieved if New Zealand adopts the two stage approach now accepted in Canada.

The "knowing assistance" limb of constructive trusteeship should continue to be available in cases where defendants no longer have the trust property or its traceable product in their hands. Otherwise, where defendants retain the property, two actions should be available to prospective plaintiffs. First, if they have a "pure" proprietary interest in the property they should be able to follow it into the defendant's hands pursuant to a common law or equitable tracing claim. Alternatively, the remedial constructive trust should be available as a remedy for plaintiffs who do not have a "pure" proprietary interest in property, but who claim that they have been unjustly deprived of a benefit to which they are entitled.

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